No. 21,119

In the United States Court of Appeals for the Ninth Circuit

SADIE KATZ, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

On Appeal from the Judgment of the United States District Court for the Central District of California

BRIEF FOR THE APPELLEE

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INDEX

CITATIONS

Cases:

Cases—Continued Page

Statutes:

Miscellaneous:

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OPINION BELOW

The District Court rendered no opinion. Its findings of fact and conclusions of law (R. 236-240) are reported at 255 F. Supp. 642.

JURISDICTION

This appeal involves federal estate taxes. The date of death was February 27, 1960. The taxes in dispute were paid as follows: $54,405.44 as deficiency tax, plus interest of $3,572.13, or a total of $57,977.57 on September 14, 1962. (R. 9.) Claim for refund of

$57,977.57 was filed on July 1, 1963 and was rejected on February 12, 1964. (R. 7, 9.) Within the time provided in Section 6532 of the Internal Revenue Code of 1954, and on January 16, 1964, the taxpayer brought this action in the District Court for the recovery of $57,977.57, plus interest. (R. 2-4.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346(a)(1). The judgment of the District Court was entered on February 11, 1966. (R. 241.) Within sixty days thereafter, on April 8, 1966, a notice of appeal was filed by the taxpayer (R. 243.) Jurisdiction is conferred on this Court by 28 U.S.C., Section 1291.

QUESTIONS PRESENTED

1. Whether the full value of property, assumed to be community property for purposes of the motion for summary judgment, which was transferred to a trust by the decedent, Leroy J. Katz, with the written consent of his wife, became the separate property of the decedent and thus includible in full in his gross estate under Section 2036 and 2038 of the Internal Revenue Code of 1954 by virtue of the rights retained by him, or whether the property in the trust was a community asset until the death of the decedent so that only one-half of the value of the trust property is includible in his gross estate.

2. In the alternative, whether the portion of the trust property attributable to the wife's one-half interest in the community, is includible in the decedent's estate under Section 2041 of the Code (relating to powers of appointment).

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of the statutes and Treasury Regulations may be found in the Appendix, *infra*.

STATEMENT

The essential facts as found by the District Court (R. 236-240), supplemented by the record, may be summarized as follows:

The taxpayer, Sadie Katz, was the wife of Leroy J. Katz, the decedent herein, who died on February 27, 1960. On that date both taxpayer and decedent were residents of California. On August 24, 1956, decedent created a trust (referred to herein sometimes as the Katz trust) naming himself as the trustor, and the Title Insurance and Trust Company, Los Angeles, California, as trustee. The Government concedes, solely for purposes of its motion for summary judgment, that prior to the execution of the instrument creating the Katz trust, the property placed in the trust was the community property of taxpayer and decedent. (R. 237, 238.)

Section four of the trust instrument provided that the Trustor, Leroy J. Katz, retained rights to the property transferred to the trust, including the right to "collect, receive, and disburse, without accounting to the Trustee *or any other person*, all income" from the property. (Emphasis supplied.) (R. 64.) Under Section thirteen of the trust instrument the Trustor, Leroy J. Katz, reserved the right "to revoke, terminate or amend" the trust at any time. (R. 69, 237.)

Under the terms of the trust as they existed at the time of decedent's death, the taxpayer upon the death of her husband was entitled to 80 percent of the trust income for life and the two children of the spouses were entitled to 20 percent; and after the taxpayer's death the trust was to continue for the benefit of the children and their issue. (R. 65-68, 79-86.)

Taxpayer, having been advised by counsel, executed the original Declaration of Trust by signing a portion thereof headed "Approval of Wife" in which she expressed full approval of the Declaration of Trust. (R. 72, 192, 237.) In addition, Leroy J. Katz exercited his right to amend the trust on two different occasions, i.e., April 27, 1957 and October 21, 1958, and on each occasion taxpayer signed a consent to such partial amendments under the heading "Consent of Trustor's Wife to Partial Amendment," which provided that taxpayer "[does] hereby consent to and fully approve the foregoing Partial Amendment." On each of these occasions taxpayer was advised by counsel. (R. 83, 86, 237-238.)

No oral or collateral agreements between Leroy J. Katz and taxpayer existed concerning the trust or the property which was the res of the trust, or which were at variance with the terms of the trust. The trust instrument expresses the full intent of the parties to the trust. (Dep. 14, 29-30; R. 238.)

The District Court found and held that by virtue of execution of the trust instrument, under the circumstances described, the property transferred to the trust became the separate property of the decedent, Leroy J. Katz, "since, under the terms of the trust,

he was accorded the right solely to enjoy the income from the trust and was given the power to revoke, terminate or amend the trust. These rights and powers vested in the said decedent control of, and the beneficial enjoyment of, all of the trust property." (R. 238.)

SUMMARY OF ARGUMENT

The District Court correctly held that in the absence of any underlying oral or collateral agreements changing the effect of the express, written terms of the Declaration of Trust involved herein, the necessary legal effect of taxpayer's approval of the trust instrument was to part with her community interest in the property transferred to the trust and to make it all the separate property of her husband, the decedent herein. The evidence as a whole supports the District Court's finding that taxpayer, with the advice of the family attorney, whom she subsequently employed after her husband's death, gave her full approval to the terms of the trust agreement.

A husband's investment of community funds in life insurance or annuity policies is, contrary to taxpayer's assumption, not necessarily or always the same as the arrangements represented by creation of an inter vivos trust with community funds. And moreover, while a husband may be regarded as acting as manager of the community in some cases when he creates a revocable inter vivos trust and funds it with community property, nevertheless, the wife may give her consent or approval to the creation of new

or different rights. The husband and wife by joint action may make any disposition of their community property that they choose to make. Thus, the wife in the instant case parted voluntarily with her interests in the community property as they existed before the transfer in trust and succeeded to a new and different interest in the property which was governed by the terms of the trust.

In the proceedings below, it was assumed by all concerned that the instant trust was valid, and taxpayer's belated contention to the contrary is out of order and not permissible for purposes of this appeal. In any event, the point is without merit, and the trust was valid under California law even though decedent retained the income for life and also a power of revocation.

Since the decedent had the right to the trust income and the power to revoke the trust during his lifetime, the entire trust property is clearly includible in his gross estate for purposes of the federal estate tax under Sections 2036 and 2038 of the 1954 Code if as held by the District Court the entire property transferred to the trust became his separate property by agreement of the spouses.

And even if the wife continued to be the owner of a community one-half of the property placed in the trust, still, she gave to the decedent such broad powers over her share as to constitute a general power of appointment. He could exercise such powers for his own benefit and hence, her share would be includible in his gross estate under Section 2041 of

the Code. In view of its disposition of the case, the District Court did not need to reach this alternative contention.

ARGUMENT

I

The District Court Correctly Held That in the Absence of Any Underlying Oral or Collateral Agreements Changing the Effect of the Express, Written Terms of the Declaration of Trust, the Necessary Legal Effect of Taxpayer's Approval of the Trust Instrument Was to Part With Her Interest in the Community Property Transferred to the Trust

A. *Introduction*

The estate tax here disputed was imposed on the estate of the decedent, and is attributable to the inclusion in his gross estate of the entire corpus of a trust established by him on August 24, 1956.[1] Taxpayer contends that only one-half should be included because the trust was established with community property in which each spouse had a one-half interest. If the taxpayer's one-half interest in the community property transferred in trust was transmuted into the separate property of the decedent, then the entire trust property is includible in the gross estate of the decedent under Sections 2036 and 2038 of the

[1] This appeal is from a summary judgment for the Government and against the taxpayer. Solely for purposes of the motion for Summary Judgment, the Government agreed that the property transferred to the subject trust was community property prior to its transfer. In the event that this appeal is decided in favor of the taxpayer, the case should be remanded for such further proceedings as may be appropriate.

Internal Revenue Code of 1954 (Appendix, *infra*) by virtue of the fact that under the trust instrument the decedent reserved the right to the income for his life and retained the power to revoke or terminate the trust and withdraw the corpus. The District Court so held.

California Bankers Association has filed a brief as Amicus Curiae because of the interest of its member banks in administering revocable inter vivos trusts and because of the alleged effect on such trusts of the construction given by the District Court to the trust involved in this case. The statement is made by Amicus Curiae (Br. 2) that where a trust is established with community property, the settlors "normally" have no intention of changing the nature of their property from community to something else during the period the trust is revocable. This is limited, parenthetically, to situations where the husband is acting as manager of the community or the husband and wife act together. We recognize that an inter vivos trust created jointly by husband and wife with community property and revocable by their joint action does not change the nature of community property. *Bank of America Nat. Trust & Savings Ass'n* v. *Rogan*, 33 F. Supp. 183 (S.D. Cal.). And, of course, if the husband is in fact acting as manager of the community in establishing an inter vivos trust, there is no intent to change the character of the community property transferred in trust. However, to suggest that the District Court's holding frustrates the "normal desires and expentancies" of parties to inter vivos trusts under the facts of the instant case, as does

Amicus Curiae (Br. 3), is without fundation and it is inappropriate for Amicus Curiae to make such a statement on the basis of the present record.

The facts material to the issue of transmutation of community property to separate property are as follows:

On August 24, 1956, the decedent created a trust naming himself as the trustor and Title Insurance and Trust Company, Los Angeles, California, as the trustee. As indicated above, for purposes of the motion for summary judgment the Government conceded that prior to its transfer in trust the property involved was the community property of decedent and his wife, the taxpayer herein. Under Section Four of the Declaration of Trust Mr. Katz was vested with the sole power to collect and disburse all trust income "without accounting to the Trustee or any other person." Section Four also provided (R. 64):

> The Trustee shall not exercise any of the powers set forth in SECTIONS ONE, TWO AND THREE hereof without first obtaining the written consent of the Trustor, during his lifetime, and after his death without first obtaining the written consent of all of the adult beneficiaries who are then entitled to receive the income hereunder.

Sections One, Two, and Three contain provisions setting forth the trustee's powers relating to the management of the real and personal property.

Under Section Thirteen Mr. Katz reserved the right "to revoke, terminate or amend" the trust at any time. (R. 69.) After the death of Mr. Katz, the

taxpayer was given a life estate in 80 percent of the trust income, and at her death the remainder of the trust estate was to be held for the benefit of the children of the spouses and their issue. (R. 79-86.)

The taxpayer executed the original Declaration of Trust by signing a portion thereof headed "Approval of Wife" in which she expressed full approval of the Declaration of Trust. (R. 72.) Sections Five, Fourteen, and Fifteen of the trust were amended by Mr. Katz on April 27, 1957. Section Six of the trust was amended by Mr. Katz on October 27, 1958. In both instances the taxpayer signed a consent to such partial amendments under the heading "Consent of Trustor's Wife to Partial Amendment", which provided that taxpayer does "hereby consent to and fully approve the foregoing Partial Amendment." (R. 79-83, 84-86.)

It is well established that for a transfer of community personal property by the husband to be voidable at the suit of the wife it must be shown to have been made not only without consideration, but also without the written consent of the wife. *Metzger* v. *Vestal*, 2 Cal. 2d 517, 522, 42 P. 2d 67, 69; *Spreckels* v. *Spreckels*, 172 Cal. 775, 784, 158 Pac. 537, 540. In the *Metzger* case there was a transfer to the son of stock in a newly formed corporation, assets of which had constituted community property. It was held that such transfer was not voidable by the wife's assignees although unsupported by consideration, since the wife had consented in writing to the gift to the son. Taxpayer seeks to distinguish *Metzger* on

the ground that there was an underlying oral agreement in *Metzger*, whereas there is no such oral agreement in the instant case. A careful reading of *Metzger* indicates that the oral agreement is significant there only because the wife's action in signing the instruments of transfer and the articles of incorporation was ambiguous without the explanation afforded by the oral agreement. In the instant case, Sadie Katz' written approval of the creation of the trust is unambiguous, and as shown below she has testified that the parties did not have any oral or collateral agreements at variance with the terms of trust.

B. *Taxpayer consented to the Declaration of Trust with advice of counsel and without any oral or collateral agreements at variance with the terms of the trust*

The facts concerning the taxpayer's consent to and approval of the Declaration of Trust and amendments thereto are relevant. The District Court found (R. 237-238) that taxpayer had been advised by counsel at the time that she gave her consent to the trust and amendments. The taxpayer's deposition, taken November 17, 1965, reveals the following (Dep. 12):

Q. By Mr. Fenmore. When Mr. Katz was alive who was your attorney?
A. Mr. Fischgrund, Sidney Fischgrund.
Q. How long had he been your attorney?
A. As long as we were in Los Angeles.
Q. Since 1940?
A. Since 1940.
Q. Who hired him?
A. My husband.

Q. Did you continue to hire him after Mr. Katz passed away?

A. Yes, we had great faith in him.

Q. Did you meet with Mr. Fischgrund often?

A. Whenever it was necessary.

Q. Mrs. Katz, did you attend business meetings with your husband?

A. Yes. He never went anywhere without me.

Q. Did he keep you apprised of all of his business activities?

A. Oh, yes. We were always together.

The Declaration of Trust and the partial amendments were each signed by Sidney Fischgrund as attorney for the trustor, indicating that he participated in the establishment of the trust. Continuing with the deposition of taxpayer (Dep. 14-15):

Q. Did you fully agree with the form of this trust?

A. Surely.

Q. Did you ever attend any meetings when the trust was created?

A. Surely, yes.

Q. Where did these meetings take place, do you remember that?

A. Well, Title Insurance and Trust.

Q. Do you remember who was present at the meetings?

A. Oh, I wouldn't know.

Q. Do you remember basically what was discussed at these meetings?

A. You discuss the format, I guess.

Q. At that time did you tell the trust officer that you agreed with the trust or did you tell him that you objected in any way to the trust?

A. No, we did it together according to their advice.

Q. Did you ever intend to interfere with the trust?

A. Oh, no.

Later on during the deposition of the taxpayer the following as to absence of collateral agreements was brought out (Dep. 29-30):

Q. According to your best knowledge, the trust that you created with your husband, was there any conditions that were imposed upon the trust that didn't appear on the document itself; that is, is the trust instrument a clear reflection of the intent that you and Mr. Katz intended?

MR. KESTEN: I will object to the form of the question.

MR. FENMORE: I will rephrase the question.

Q. You remember signing the trust instrument?

A. Yes.

Q. In that trust instrument is there contained everything which you intended and which Mr. Katz intended to be in the trust?

A. Yes, yes.

Q. Did you have any other understandings beyond what was contained in that trust agreement concerning the property?

A. No.

Taking into account the taxpayer's testimony as to (1) her relationship to the attorney, Sidney Fischgrund, then and after her husband's death, (2) her participation in the meetings when the trust was created, (3) her understanding that the trust agreement contained everything the parties intended, and

(4) the absence of any collateral agreements or understandings beyond what was contained in the trust agreement, it is clear that there is adequate support for the District Court's Finding of Fact No. 7 that taxpayer's consent to the Declaration of Trust was made with advice of counsel, and for the District Court's Finding of Fact No. 9 that the parties did not have any oral or collateral agreements concerning the trust or the property which was the res of the trust, or which were at variance with the terms of the trust, and that the trust expresses the full intent of the parties. (R. 237, 238.)

C. *Taxpayer, by her written consent to the transfer in trust of the property involved, waived any community property rights she may have had in the property prior to the formation of, and conveyance to, the trust*

1. Kirkwood v. Bank of America *supports the District Court's holding*

Appellee has been unable to find any case passing upon the question of whether a transmutation of community property to separate property occurs under facts identical to the facts in the instant case; however, a case which is nearly identical in its facts and which holds that a transmutation occurs is *Kirkwood* v. *Bank of America*, 43 Cal. 2d 333, 273 P. 2d 532. This case dealt with a situation wherein the husband, with the written consent of the wife, created a trust entirely of community property. The trust agreement provided that during the husband's life all net income was to be paid to him or expended in his behalf, and that if the wife survived him, the trust estate

was to be divided into two parts, designated as Part A and Part B. The wife, if she survived, was to receive the income of both parts and, in addition, was given the right to amend or revoke as to Part A. The husband retained the power to amend or revoke the trust agreement.

A question arose on the death of the husband as to the application of Section 13554 of the California Revenue and Taxation Code, which provides in the case of an inter vivos transfer of community property from husband to wife that only one half of the property transferred is subject to the inheritance tax. The court stated (43 Cal. 2d, p. 335, 273 P. 2d, p. 533):

> The sole question to be determined is whether the widow here, who takes the major portion but less than the entire property transferred to herself and others pursuant to the terms of an *inter vivos* revocable trust created with her written consent from community assets during her husband's lifetime, is entitled to a community property exclusion to the extent of one-half of the entire property transferred in trust or only to an exclusion of one-half of the property transferred in trust to her.

The court sustained the lower court's holding that the wife was entitled to a community property exclusion only to the extent of one-half of the property transferred in trust to her. Thus, she was entitled to an exclusion of one half of the sum of (a) the value of Part A, as to which she held the power to amend or revoke, and (b) the value of her life estate in Part B. Taxpayer contends that the court treated the in-

terest which the wife received from the trust as community property in allowing her the exclusion of one-half of such amount for purposes of the California inheritance tax; however, Section 13554 applies to a gift arising out of the *transfer* of community property. The significant factor here is the court's treatment of that portion of the original community property which the widow relinquished to the trust as being transmuted to separate property. It is this portion of the community to which the court directed its attention when it stated (43 Cal. 2d, p. 339, 273 P. 2d, p. 535):

> As appears from the trust agreement, the primary purpose and intent of the trustor was that the two sons should have the ultimate ownership of all the property in equal shares, with their mother entitled to at least a life interest therein, and more than that if she desired or needed it. The trust was designed to avoid probate proceedings on the death of both spouses. The husband was the transferor, with his wife's consent. * * * At the time of the transfer she had the power of restraint, Civ Code, Section 172 (a), but instead of exercising it by withholding her signature, * * * she, with advice of counsel signed a formal consent, to "all of the terms and conditions" of the "Trust Agreement." She thereby parted voluntarily with her expectant statutory rights in the community property as they existed before the transfer, and she succeeded to a new and different interest in the property subject to the trust upon giving her consent to the *inter vivos* disposition breaking up the community status of the property transferred.

As noted above, the facts of the instant case are substantially identical to the facts in *Kirkwood*. Both cases involve the transfer of community property to a revocable inter vivos trust, with the written consent of the wife, with the husband retaining the income for his life and the power to amend or revoke the trust. In both cases the wife had the advice of counsel.

Amicus curiae makes the argument (Br. 34, 35) that the powers of the husband in *Kirkwood* to amend or revoke the trust were powers held in a fiduciary capacity as manager of the community. If the wife retained a community interest in the rights and powers of the husband under the trust instrument, then she continued to hold a present, existing, and equal interest in the trust estate until her husband's death, and the court was in error in rejecting the wife's argument that she was entitled to exclude from the transfer an amount equal to one-half the net value of the entire trust property because that amount "already belonged to her" as community property. The suggestion that the husband's powers under the express terms of the trust agreement were held as manager of the community is certainly not in harmony with the court's statements to the effect that the community status was broken up when the wife consented to the creation of the trust and the transfer of community property thereto.

Amicus curiae seeks to distinguish *Kirkwood* from the instant case on the grounds (Br. 36) that *Kirkwood* involved pre-1927 community property while the instant case involves post-1927 community prop-

erty. For California inheritance tax purposes, no distinction is made in the treatment of community property according to whether the property was acquired before 1927 or after 1927. *Kirkwood* v. *Bank of America, supra; Estate of Atwell,* 85 Cal. App. 2d 454, 461, 193 P. 2d 519, 523.

The point is made by Amicus Curiae (Br. 24) that taxpayer and her husband could not have intended to convert the community property into separate property since there was a tax detriment in doing so. However, the fact that greater tax burden results from planning one way as opposed to another does not warrant reconstructing what was actually done by the parties. As was stated in *Kirkwood, supra* (43 Cal. 2d, p. 340, 273 P. 2d, p. 535), "When the trustor and his wife had the question of the disposition of their community property under consideration, they were chargeable with notice that the impact of the inheritance tax would depend upon the method of transfer which they chose to adopt. The choice was made voluntarily and the tax consequences must follow accordingly." In the same view, the absence of tax avoidance motives (T. Br. 46) does not change the legal effect of what was done by taxpayer and her husband.

2. *The evidence as a whole supports the District Court's finding that taxpayer, by her written consent to the creation of the trust, parted with her interest in the community property transferred to the trust*

Taxpayer makes the argument under various headings that taxpayer did not waive her community

property rights in the property transferred when she gave her approval to the creation of the trust because she lacked the requisite intent to transmute the community property into the separate property of her husband. Whether a husband and wife have agreed to transmute the character of property is a question of fact to be determined on the basis of all the evidence. Taxpayer looks to separate elements of the trust transaction, such as the husband's powers of management under the trust instrument and the taxpayer's benefits thereunder, and argues that her intent or tacit approval to transmute the community property cannot be found in such elements. The Government's argument, and the District Court's findings, are not based solely on one or more elements of the trust instrument or one or more of the circumstances surrounding its execution, but on all of the evidence. And a finding based on sufficient evidence, not inherently improbable, is conclusive on appeal. *Machado* v. *Machado*, 122 Cal. App. 218, 9 P. 2d 872; *Estate of Helm*, 6 Cal. App. 752, 45 P. 2d 250; 10 Cal. Jur. 2d, Community Property, Section 59. The pertinent provisions of the trust instrument and the circumstances of taxpayer's consent to the trust are discussed above and fully support the conclusion of the District Court that the taxpayer parted with her interest in the community property transferred to the trust.

In effect, the taxpayer's argument in regard to intent is that she was unaware of or mistaken about the legal effect of her consent to the transfer in trust. This is similar to the wife's position in *Schindler* v.

Schindler, 126 Cal. App. 2d 597, 272 P. 2d 566, in which the question was whether real property purchased with community funds and placed in joint tenancy was community property subject to disposition in the pending divorce proceedings. The court stated (126 Cal. App. 2d, p. 601, 272 P. 2d, p. 568):

> It is common knowledge that innumerable husbands and wives with little or no information about estates in real property acquiesce without reflection in the suggestion that they place purchased property in joint tenancy. This estate, of course, has certain advantages. Usually not until marital discord reaches the critical stage of dividing community assets does one of the spouses —generally the one found to be innocent of wrong-doing and therefore entitled to more than half of the community property—first learn of the disadvantages of joint tenancy. At that point the issue of lack of comprehension, or absence of consent to the creation of the joint tenancy estate inevitably arises.

The court noted that the husband, despite his powers of management of the community, is subject to the limitations of California Civil Code Sections 172 and 172(a) and must have the wife's consent in transferring community funds into joint tenancy property, citing *Britton* v. *Hammell*, 4 Cal. 2d 690, 692. Further, the court stated (126 Cal. App. 2d, pp. 604-605, 272 P. 2d p. 570-571):

> In the instant case, the wife signed the papers involved in the purchase of the property. In so doing, and in the absence of fraud or misrepresentation, she clearly participated in the trans-

> action and thereby consented in writing to the transfer of community funds to joint tenancy property. Respondent further testified in response to interrogation that she "*just thought it belonged to both of us*" and believed that it was community property. There is no testimony that she revealed those evanescent thoughts to appellant or to anyone else. * * *
>
> It is of no significance that the respondent stated she was unaware of or mistaken about the legal effect of the deed. Nor is it material that the home was purchased primarily from community funds. Those facts, taken together, provide no basis for an inference of a mutual understanding or agreement between the husband and wife that the community nature of the property was to be preserved regardless of the form of the deed. (Emphasis added.)

It is noted that taxpayer in the instant case revealed a similar lack of knowledge when she stated that she did not know the difference between community property or joint tenancy. (Dep. 21-22.)

In the absence of any written or oral agreements at variance with the terms of the trust (based on taxpayer's testimony), taxpayer's consent to the trust, with the advice of attorney Sidney Fischgrund whom she trusted and subsequently employed after Mr. Katz' death, amounted to the consent required under Sections 172 and 172(a) of the California Civil Code (Appendix, *infra*).

D. *The three principal cases relied on by taxpayer and amicus curiae do not support the contention that she retained a community interest in the trust under the facts obtaining in this case*

1. *Commissioner v. Chase Manhatten Bank*

In *Commissioner* v. *Chase Manhattan Bank*, 259 F. 2d 231 (C.A. 5th), certiorari denied, 359 U.S. 913, it appeared that a husband in a community property state (Texas) created an insurance trust the principal of which consisted of insurance policies on his life. All premiums were paid out of community property. Upon his death the income was to go to his wife for life, and when she died, the principal was to go to the settlor's descendants. The husband reserved the right to revoke the trust and change the beneficiaries of the insurance. When he died, the trust became irrevocable and the rights of the beneficiaries vested. In the circumstances, the Court of Appeals held that the husband acted as manager of the community in creating the trust and held the right of revocation in that capacity. Hence the court held that the wife retained her community interest and when the husband died she made a taxable gift of half the proceeds of the insurance less only the value of her retained life estate in that half. And the court reached the same result in respect to another *inter vivos* trust created out of community property the principal of which consisted of various securities.

The *Chase Manhattan* case is clearly distinguishable from the instant case because no question as to transmutation of property from community to separate property was involved therein. Indeed, the wife

in that case did not even learn of the existence of the trusts until after the husband died; and in the circumstances there was no basis for any contention that she relinquished her community rights when the trusts were created.

In discussing *Chase Manhattan* the statement is made in the Amicus Curiae brief, at pages 16-17, that since under Texas community property law a husband can give away community property without his wife's consent as long as it is not in fraud of her rights, and since under California community property law a husband can give away community property with the wife's consent—it must follow that "the unilateral, nonfraudulent designation by a Texas husband, of a third party beneficiary under a 'community' insurance policy or inter vivos trust has the same effect as a similar designation by a California husband with his wife's consent or approval." There are two aspects to this statement, one relating to life insurance policies and the other relating to *inter vivos* trusts.

With respect to life insurance, it is clear that under California community property law a wife surrenders her community property interest in the *proceeds* of a policy on her husband's life by endorsing her consent to the designation of a beneficiary other than herself. *Ettlinger* v. *Connecticut Gen. Life Ins. Co.*, 175 F. 2d 870 (C.A. 9th). It can be said that the wife's consent to the California husband's designation which is in effect on the death of the husband, and the Texas husband's nonfraudulent designation both result in taxable gifts from the wife upon the

husband's death, assuming other incidents of ownership of the policy had not been disposed of by the wife prior thereto. But this hypothetical tends to be misleading in that it ignores the hybrid nature of the property represented by life insurance policies, including the fact that the power to change the beneficiary is but one of the incidents of ownership of a life insurance policy, and that it is possible for the wife to release her entire interest in the policy and convert it into the separate property of the husband. This is discussed in this Court's opinion in *United States* v. *Stewart*, 270 F. 2d 894, 898 (C.A. 9th).

As it relates to *inter vivos* trusts, the statement quoted from the Amicus Curiae brief is significant in that it attempts to equate the designation of beneficiaries, and gift from the community which occurred when the revocable trusts created by the husband in *Chase Manhattan* became irrevocable upon his death, to the case of a transfer in trust by a California husband, with his wife's consent, with third parties designated as beneficiaries of the trust. If the reference is to a California trust which is irrevocable and not subject to amendment at the time that the wife gives her consent or approval, it is clear that the wife has consented to the gift from the community to the designated third party beneficiaries of the trust. On the other hand, if the reference is to a trust which may be amended or revoked by the husband, with third parties designated as beneficiaries, and the wife consents to its creation, as in *Kirkwood*, *supra*, and the instant case, it would seem clear that the wife

has consented to all the terms of the trust, including the husband's power to amend or revoke the trust, and has relinquished to her husband her interest in the community property transferred in trust, at least in the absence of evidence showing that no such relinquishment was intended.

2. *United States v. Stewart*

Taxpayer (Br. 22) and Amicus Curiae (Br. 5) also rely on the decision of this Court in *United States* v. *Stewart*, *supra*, as being contrary to the holding of the District Court in the instant case. The primary question presented in *Stewart* was whether one-half of the cash value of 26 policies on the life of the husband which had been purchased with community funds was properly includible in the wife's gross estate for federal estate tax purposes. In order to decide this question it was necessary first to determine whether the policies were community property at the time of the wife's death and, deciding this to be the case, it was necessary to analyze the nature and extent of the decedent's interests in the policies under California law.

In reaching the decision that the wife had present, existing and equal interests in the policies at the time of her death and that this amounted to ownership of one-half of the value of the policies at such time, resulting in their inclusion in her gross estate, this Court made a careful analysis of the manner in which the California community property system affects incidents of ownership in a life insurance policy. In

this connection the Court stated the principle underlying its analysis as follows (p. 898):

> While life insurance, because of its hybrid nature, is necessarily accorded individualistic treatment in the law generally, this fact has apparently not been regarded by the California courts as requiring that it be treated *sui generis* for purposes of the community property laws. We find nothing in California law which indicates that life policies as items of community property are treated by rules other than or different from those pertaining to community property generally.

The taxpayer relies on *Stewart* in making the argument by analogy that a revocable *inter vivos* trust established with community property should be treated, for federal estate and gift tax purposes, the same as an annuity or insurance policy purchased by the husband with community founds. The basic fallacy of this argument by analogy is that the analysis in *Stewart* starts with the *fact* that life policies, with all their attributes, are initially items of community property if purchased with community funds, whereas taxpayer's argument utilizes the community property rules applicable to such attributes of life policies (as developed in *Stewart*) as a basis for contending that the attributes of a revocable trust should be similarly treated, without regard to whether such trust is community property in the first instance. The basic question in this case is whether Sadie Katz relinquished her interest in the community property transferred to an *inter vivos* trust when she gave her approval to the trust instrument under which her hus-

band reserved the right to the income for his life and retained the right to amend or to revoke or terminate the trust. The application of California community property law to the attributes of an insurance policy, as developed in *Stewart*, is not relevant to this case unless the subject *inter vivos* trust is an item of community property in the first instance. However, under the holding in *Kirkwood* v. *Bank of America*, *supra*, it is clear that Mrs. Katz relinquished her interest in the community property "upon giving her consent to the *inter vivos* disposition breaking up the community status of the property transferred." 43 Cal. 2d, p. 339, 273 P. 2d, p. 535. If Mr. Katz had terminated the trust, the trust estate would have vested in him as his separate property, not as community property. If Mr. Katz had established the trust with community funds without the consent of his wife, as did the husband in *Chase Manhattan*, *supra*, he would be regarded as acting for the community, and upon termination of the trust the trust estate would have vested in Mr. Katz as community property. However, it is of no avail to taxpayer to argue the tax consequences contrary to the realities of this case.

3. *Estate of McGowan v. Commissioner*

Amicus Curiae cites *Estate of McGowan* v. *Commissioner*, 43 B.T.A. 695, appeal dismissed, 123 F. 2d 64 (C.A. 9th), as holding in effect that community property transferred to a revocable trust retains its character as community property. (Br. 20-22.) This estate tax case involved the transfer of two parcels

of real estate to a revocable inter vivos trust in 1929. One parcel was the husband's separate property and there was a question as to the respective interests of the husband and wife in the other parcel. Subsequent to the transfer in trust the parties entered into an agreement that all their property be held in community. The husband died in 1937, and the Government included the entire trust property in the decedent's estate under Section 302(d) of the Revenue Act of 1926, as amended by Section 805 of the Revenue Act of 1936. The pertinent statute provides for inclusion in the gross estate to "the extent of any interest therein of which the decedent has at any time made a transfer" where the enjoyment thereof was subject to any change through the exercise of a power by the decedent to alter, amend, or revoke, etc. The Board of Tax Appeals held that the transfer of the separate parcel by a revocable trust was not affected by the subsequent community property agreement and was includible in the decedent's estate. See *Helvering* v. *City Bank Farmers Trust Co.*, 296 U.S. 85. It also held that the same reasoning applied to the transfer by revocable trust of the other parcel of real estate to the extent of the decedent's interest. The Board stated (p. 699) that the extent of such interest "depends upon the proportions of the investment in the tract which decedent, his wife, and the marital community contributed." The Board went on to find that the wife's separate funds were the source of one-ninth of the purchase price and the "other eight-ninths was community property until the transfer in

trust." On this basis the Board found that the decedent's transfer under Section 302(d) was one-half of the community contribution, or four-ninths of the parcel, and the latter proportion was includible in his estate. In determining the amount transferred to the revocable trust by the decedent which was subject to Section 302(d), the Board was not concerned with the character of the property after its transfer in trust, and thus the inference drawn in the Amicus Curiae brief at page 22 with respect to the character of the trust property is clearly erroneous.

E. *The trust involved was validly created*

Taxpayer is urging as ground for reversal a point not raised in the court below.[2] Taxpayer for the first time raises a question as to the validity of the trust created by Leroy J. Katz with taxpayer's consent on August 24, 1956. (Br. 36.) Taxpayer recognizes that the retention by Leroy J. Katz of the right to the income of the trust and retention of the power to amend or revoke the trust, either alone or in combination, do not affect the validity of an inter vivos trust in California. *Nichols* v. *Emery*, 109 Cal. 323, 41 Pac. 1089. (Br. 37.) However, taxpayer urges that because of the control over the trust administration reserved by Leroy Katz in Section Four of the Declaration of

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[2] It is at least doubtful whether taxpayer should be permitted to raise this point on the instant appeal and we submit she should not. *General Utilities Co.* v. *Helvering*, 296 U.S. 200; *Bank of California* v. *Commissioner*, 133 F. 2d 428, 433 (C.A. 9th). In any event, the point is without merit, as we have shown above.

Trust no effective trust was created. (Br. 38-40.) Section Four provides (R. 64):

> During the lifetime and competency of the Trustor, the Trustee shall have no rights, duties, or powers with respect to any property held under this trust, it being understood that the trustor retains all such rights, and shall collect, receive, and disburse, without accounting to the Trustee or any other person, all income of every nature and description from the real and personal property held hereunder.
>
> The Trustee shall not exercise any of the powers set forth in SECTIONS ONE, TWO, AND THREE hereof without first obtaining the written consent of the Trustor, during his lifetime, and after his death without first obtaining the written consent of all of the adult beneficiaries who are then entitled to receive the income hereunder.

To construe the first paragraph of Section Four as providing that the trustee actually had no rights, duties, or powers with respect to any property during the trustor's lifetime, as contended by taxpayer (Br. 39), is inconsistent with the provision in the second paragraph that the trustee shall not exercise the powers in Sections One, Two, and Three, the sections defining the trustee's administrative powers, "without first obtaining the written consent of the Trustor, during his lifetime * * *." Obviously, there is no point in providing that the trustee shall obtain the trustor's written consent before exercising powers if it cannot exercise such powers in any event during the trustor's lifetime, which is the case if the first paragraph of Section Four is read literally. Section

Fourteen provides: "At the time when the Trustee assumes *full* management of this trust, the following powers are conferred upon the Trustee * * *." (R. 69.) The inference is clear that the trustee had some management function prior to the time when Section Fourteen became effective on the death of Leroy Katz. It is also provided that the trustee shall receive an annual fee of $360 during the trustor's lifetime. (R. 70.) Such a fee is more than the fee of a mere custodian of securities or the cost of a safe deposit box.

In view of the above described ambiguity of the trust instrument as to the trustee's administrative duties, the burden was on taxpayer to introduce evidence as to the intent of the parties with regard to the trustee's duties, in particular to show what duties the trustee actually performed during Mr. Katz' lifetime. Taxpayer's failure to raise this issue in the court below perhaps accounts for this omission. The record does indicate that the trust res was never a part of the estate of Leroy Katz for other than tax purposes. The District Court in its Finding No. 12 indicates that taxpayer failed to assert any right she may have had to set aside the trust and is accepting benefits under the trust. (R. 238.)

Assuming, as taxpayer contends (Br. 39), the trustee held bare legal title to the trust res during Mr. Katz' lifetime, subject to an obligation to reconvey or transfer the property as requested by Mr. Katz, the trust is still regarded as a valid trust under California law. *Reiss* v. *Reiss*, 45 Cal. App. 2d 740, 746, 114 P. 2d 718, 722; *Hansen* v. *Bear Film*

Co., 28 Cal. 2d 154, 172, 168 P. 2d 946, 958. The trend in California and elsewhere is to recognize the validity of an inter vivos trust despite the retention of powers to amend, revoke, and control the trust during the trustor's lifetime. Bogert, Trusts and Trustees (2d ed.), Sec. 104; 1 Restatement of Trusts (2d), Sec. 57; 164 A.L.R., Annotation, 881, 889. In *Monell* v. *College of Physicians & Surgeons*, 198 Cal. App. 2d 38, 17 Cal. Rptr. 744, the court cites with approval Section 57 of the Restatement of Trusts (2d).

Arguing that a dry trust was created, taxpayer asserts that the interest of the settlor, the trustee, and the beneficiary are the same under the instant Declaration of Trust. (Br. 40.) In doing so, she ignores the fact that the Declaration of Trust vests specific interests in her and the children of taxpayer and Mr. Katz, subject to divestment under Mr. Katz' powers to amend or revoke the trust. The reservation of a power of revocation in the settlor does not prevent the vesting of an interest in the beneficiary, although it is an interest subject to be divested by the exercise of the power. 1 Scott, Trusts (2d ed.), Sec. 57.1.

Viewing the trust instrument as a whole, the circumstances of its execution and administration, including taxpayer's consent thereto, and the fact that taxpayer treated the trust as a valid trust and is accepting benefits thereunder, the trust involved here must be regarded as a valid trust for purposes of the instant appeal.

II

In the Alternative, the Portion of the Trust Property Attributable to Taxpayer's Interest in Community Property Transferred to the Trust Is Includible in the Gross Estate of Decedent, Leroy J. Katz, under Section 2041 of the Internal Revenue Code

Since the decedent had the right to the trust income and the power to revoke the trust during his lifetime, the entire trust property is clearly includible in his gross estate for purposes of the federal estate tax under Sections 2036 and 2038 of the 1954 Internal Revenue Code if, as held by the District Court and contended by us above, the entire property placed in the trust became his separate property by agreement of the spouses.

However, even if the wife continued to be the owner of a community one-half of the property, and thus placed it in the trust herself, still, she gave to the decedent such broad powers over her share as to constitute a general power of appointment within the meaning of Section 2041 of the 1954 Internal Revenue Code and Section 20.2041-1 of the Treasury Regulations on Estate Tax (1954 Code) (Appendix, *infra*).

There can be no question that the clear language of Sections Four and Thirteen of the Declaration of Trust gave Leroy Joseph Katz the power to affect both the beneficial enjoyment of the trust property and its income by altering, amending, or revoking the trust, and also the power to withdraw trust corpus during his lifetime. By taxpayer's appending her signature of approval to the Declaration of Trust,

she vested in her husband, Leroy J. Katz, a general power of appointment over her share of the trust corpus.

Under the requirements of Section 2041 of the Internal Revenue Code of 1954 the value of the gross estate shall include the value of all property to the extent to which the decedent had, at the time of his death, a general power of appointment. Leroy J. Katz had a general power of appointment over the entire trust res, and it must therefore be fully includible in his gross estate. Cf. *Phinney* v. *Kay*, 275 F. 2d 776 (C.A. 5th).

In view of its disposition of the case, holding that there was a transmutation of community property so that all the trust property became the separate property of the decedent, it was unnecessary for the District Court to reach our alternative point as to Section 2041, and it did not do so. However, we wish to reserve the point and submit that the decision of the District Court should be sustained on that ground even if this Court should hold that the wife retained a one-half community interest in the property placed in the trust.

CONCLUSION

The judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

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JANUARY, 1967.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated:..... day of ....., 1967.

ROBERT M. WILLAN
Attorney

APPENDIX

Civil Code, 6 West's Annotated California Codes:

Sec. 172 *Community personal property; management and control; restrictions on disposition.*

The husband has the management and control of the community personal property, with like absolute power of disposition, other than testamentary, as he has of his separate estate; provided, however, that he cannot make a gift of such community property, or dispose of the same without a valuable consideration, or sell, convey, or encumber the furniture, furnishings, or fittings of the home, or the clothing or wearing apparel of the wife or minor children that is community, without the written consent of the wife.

Sec. 172a *Community real property, managemetn and control; wife's joinder in conveyances; limitation of actions.*

The husband has the management and control of the community real property, but the wife, either personally or by duly authorized agent, must join with him in executing any instrument by which such community real property or any interest therein is leased for a longer period than one year, or is sold, conveyed, or encumbered; *provided, however*, that nothing herein contained shall be construed to apply to a lease, mortgage, conveyance, or transfer of real property or of any interest in real property between husband and wife; *provided, also, however*, that the sole lease, contract, mortgage or deed of the husband, holding the record title to community real prop-

erty, to a lessee, purchaser or encumbrancer, in good faith without knowledge of the marriage relation shall be presumed to be valid. No action to avoid any instrument mentioned in this section, affecting any property standing of record in the name of the husband alone, executed by the husband alone, shall be commenced after the expiration of one year from the filing for record of such instrument in the recorder's office in the county in which the land is situate, and no action to avoid any instrument mentioned in this section, affecting any property standing of record in the name of the husband alone, which was executed by the husband alone and filed for record prior to the time this act takes effect, in the recorder's office in the county in which the land is situate, shall be commenced after the expiration of one year from the date on which this act takes effect.

Internal Revenue Code of 1954:

SEC. 2036. TRANSFERS WITH RETAINED LIFE ESTATE.

(a) *General Rule.*—The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—

(1) the possession or enjoyment of, or the right to the income from, the property, or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

* * * *

(26 U.S.C. 1964 ed., Sec. 2036.)

SEC. 2038. REVOCABLE TRANSFERS.

(a) *In General.*—The value of the gross estate shall include the value of all property (except real property situated outside of the United States)—

(1) *Transfers after June 22, 1936.*—To the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of his death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person (without regard to when or from what source the decedent acquired such power), to alter, amend, revoke, or terminate, or where any such power is relinquished in contemplation of decedent's death.

* * * *

(26 U.S.C. 1964 ed., Sec. 2038.)

SEC. 2041. POWERS OF APPOINTMENT.

(a) *In General.*—The value of the gross estate shall include the value of all property (except real property situated outside of the United States)—

* * * *

(2) *Powers created after October 21, 1942.*—To the extent of any property with respect to which the decedent has at the time of his death a general power of appointment created after October 21, 1942, * * *

* * * *

(b) *Definitions.*—For purposes of subsection (a)—

(1) *General power of appointment.*—The term "general power of appointment" means a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate; except that—

* * * *

(26 U.S.C. 1964 ed., Sec. 2041.)

Treasury Regulations on Estate Tax (1954 Code):

Sec. 20.2041-1 *Powers of appointment; in general.*

* * * *

(b) *Definition of "power of appointment"*—(1) *In general.* The term "power of appointment" includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. For example, if a trust instrument provides that the beneficiary may appropriate or consume the

principal of the trust, the power to consume or appropriate is a power of appointment. Similarly, a power given to a decedent to affect the beneficial enjoyment of trust property or its income by altering, amending, or revoking the trust instrument or terminating the trust is a power of appointment. * * *

* * * *

(26 C.F.R., Sec. 20.2041-1.)

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